SUMMARY OF COOPERATIVE CASES

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FARMER COOPERATIVE SERVICE

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The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

COOPERATIVES - REPURCHASE OF PREFERRED STOCK

(Burk v. Cooperative Finance Corporation, 384 P. 2d 618)

This case involved the question whether a cooperative organized under Chapter 23.86 of the Revised Statutes of Washington as a cooperative corporation to engage in the finance business could repurchase its preferred stock. The Court found that there was no statutory authorization or prohibition. Accordingly, on analogy to the law applicable to general business corporations, it held:

1. That a cooperative in Washington may repurchase its own stock provided its capital stock is not impaired at the time such purchase is made;

2. Where, as here, an installment note is given in payment for the stock, the existence or non-existence of impairment must be determined at times obligations on note matured; and

3. Because of this "impairment" limitation on the repurchase, the cooperative is not estopped from asserting that the repurchase is invalid so long as any part of the repurchase agreement remains executory, any invalidity, of course, depending upon a showing of capital stock impairment.

In 1955, Burk purchased 45 shares of preferred stock from Cooperative Finance Corporation (hereafter called CFC). In 1957, he entered into an agreement with Mr. Jordan, the treasurer and apparent manager of CFC, under which he sold his stock to CFC in exchange for a $4,500 promissory note calling for payments of $74.58, plus six percent interest on the declining balance, per month. A few months later, Burk offered to lend CFC $3,000 on the same terms and Jordan again agreed. On January 1, 1958, a new promissory note for $7,342.98 (which represented the balance owing on the $4,500 note plus the $3,000 loan) was delivered to Burk in exchange for the $4,500 note. Thereafter, CFC made monthly payments of $124.83, plus six percent interest on the declining balance until February 11, 1960, when payments were discontinued. Burk then brought this suit to recover the remainder owing under the note.

CFC defended primarily on the grounds (1) that Jordan acted outside the scope of his authority and (2) that the portion of the note representing the $3,000 loan had been repaid in full, plus interest and the remainder of the note failed for lack of consideration because it was illegal for the cooperative to repurchase its own stock. The trial court found (1) that the repurchase was lawful; (2) the cooperative was

estopped to deny its validity; and (3) Jordan was acting within his corporate authority in executing the note, or, in the alternative, the cooperative had ratified his action and was estopped to deny his authority. The appellate court modified these conclusions to the extent indicated above and remanded the case for further proceedings consistent therewith.

The court pointed out that the only statutory provision relating to repurchase of stock by a cooperative (RCW 23.86.110) was inapplicable to this case because it grants unlimited authority to repurchase in only two situations: (1) the equalization of stock holdings; and (2) the purchase of stock by a stockholder who no longer produces for the cooperative. However, the court said this "is not dispositive of the question" because this statutory power is "plenary" and the authority to purchase in the absence of a surplus, does not negate the possibility of repurchases under some limited authority; e.g., repurchases out of surplus. On this point the Washington Legislature has been silent.

The court then examined the general corporation statutes (RCW 23.01) and found "parallelism to a substantial degree" respecting their stock provisions and those of the cooperative corporation statutes (RCW 23.86). It noted that while Washington has had a long established prohibition against corporations repurchasing their own stock, this had been repealed in 1947, and, under RCW 23.01.120 a general business corporation may repurchase its own stock, provided such purchases do not impair the capital stock.

Because of these statutory provisions, the court said it never had had to resolve the question whether, in the absence of statute, a corporation may repurchase its own stock. The court then looks to Washington cases and cases from other jurisdictions which indicate "a greater scope of permissiveness with regard to repurchases of stock by cooperatives" than in the case of a general business corporation. From this, it reasons as follows:

> "Having considered some of the similarities and differences of cooperative and corporation stock in view of precedents we have examined, we are faced in the last analysis with a choice as to whether cooperatives may repurchase their own stock. As previously pointed out, Washington permits all general corporations, regardless of the date of incorporation to repurchase their own stock so long as it does not impair capital stock. See: In re West Waterway Lumber Company, (1962), 59 Wash. 2d 310, 367 P. 2d 807. Since it would seem rather anomalous to impose greater restrictions upon cooperatives, which are normally given greater leeway than general corporations with regard to stock repurchases, than presently

> exist upon the general corporations of this jurisdiction, we conclude that a cooperative may repurchase its own stock so long as it does not impair capital stock. This conclusion harmonizes with the majority of American jurisdictions and the authorization of RCW 23.86.110 to repurchase in certain conditions even in the absence of a surplus."

The court then considered the estoppel issue and concluded, as indicated above, that because of this "impairment" possibility, the cooperative could not be estopped from asserting an ultra vires defense so long as any part of the repurchase agreement is executory.

The court next discussed the time at which "impairment" should be considered and whether the note in this case should be apportioned between the consideration for the stock and the debt. On analogy to cases from other jurisdictions it held, on the first point, that "the inquiry as to the impairment of capital should be directed to the time at which the obligations on the note matured." Moreover, it determined that logic required division of prior payments between the two portions of the note in the ratio between the balance owing on the $4,500 note and the $3,000 loan when the disputed note was issued.

Finally, the court said it was of the opinion that "the evidence substantially supports the conclusion of the trial court on Jordan's authority to execute the note or, in the alternative, its ratification."

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AGRICULTURAL COOPERATIVES - DIRECTORS - ABUSE OF DISCRETION

(Collie v. Little River Cooperative, Inc., 370 S.W. 2d 62)

Directors of an agricultural cooperative, it was decided by the Supreme Court of Arkansas in this case, abused their discretion in failing to develop or maintain a rational balance between amounts paid preferred stockholders and active members and in failing to provide, maintain and build an allocated reserve required by the cooperative's articles of incorporation, where preferred shareholders had been effectively denied any assurance that their stock would be redeemed as required while active members were enjoying a profitable return from the investments of the preferred stockholders.

This action was brought by preferred stockholders of the cooperative (hereafter called LRC) for an accounting and an order compelling LRC to comply with its articles of incorporation providing for payment of dividends and paying off of preferred stock. The lower court dismissed and the stockholders appealed. The stockholders involved owned about 2.3% of the preferred stock which was obtained in 1956.

LRC was organized in 1946 under the Cooperative Marketing Associations law of Arkansas to deal principally in cotton and cotton seed. The authorized 100 shares of common stock could be owned only by producers who agreed to patronize LRC; no one could hold more than one share, or transfer it without Board approval; and it did not bear dividends.

The articles of incorporation and bylaws provided that an amount not exceeding 6% of the par value of the fully paid-up preferred stock should be set aside for payments of dividends on such stock, which dividends should have preference over all other dividends and distributions; that after such payment there shall first be reserved an amount equal to not less than 5% of the net savings for the purposes of establishing and maintaining an allocated reserve of not less than 25% of the aggregate value of all outstanding stock; and that when this reserve exceeds the required 25% the board of directors may apply such excess to paying off ratably by years the oldest outstanding preferred stock in the same order as originally issued.

LRC paid a 5% dividend on preferred stock in 1956, 4% in 1957, 2% in 1958, none in 1959, 2% in 1960, 3% in 1961 and 4% in 1962. The general reserve was approximately $4,000 as of March 31, 1961 (end of fiscal year). Over the years, losses resulting from various ventures of the co-op in the amounts of $5,000, $16,000, and $1,000 have been charged against the general reserve. According to the testimony of the co-op manager, there would have been approximately $29,000 in the general reserve as of March 31, 1961, if these losses had not been deducted from the reserve.

In 1960 the net savings (profits) was $21,744.52; a 2% dividend, $4,100.00, was distributed to the owners of the 16,790 shares of outstanding preferred stock; the balance of the net profit ($17,744.52) was distributed to the 26 member and the few nonmember patrons, 95% in cash and 5% in the general reserve to the patrons' credit. In 1962 the net savings (profit) was $44,157.96; a 4% dividend, $8,200.63, was paid to the preferred stockholders; $34,752.50 was distributed as advance patronage refunds. These years were selected at random from the record.

After reciting these facts the court said in part:

> "From the record it is clear that the operation, management and control of this enterprise is absolutely vested in the hands of some 26 owners of common stock. From this group has been selected the board of directors who are responsible for the handling of the funds of the co-op. These people along with five or six non-members generally constitute the patrons of the gin here in question. It is undisputed that for many years the gin earned more than enough to pay the maximum six percent dividend to the preferred stockholders, (and to set aside the minimum five percent of profits for the allocated reserve), but rather than pay this amount the board voted to pay to themselves and the other patrons of the gin a lion's share of the savings. One of appellee's directors testified that he owns one share of common stock -- one $100 share -- and has no preferred stock; that for $100 he got in on the operation and last year alone (1961) saved $3,800.00. Appellee's explanation of the handling of the funds of the gin in this manner was, 'In order to keep the ginnings up /retain their patrons/ so can pay anything. If we pay six percent every year, there would come a time when there wouldn't be any earnings left to pay anybody anything.' Following this testimony the manager of the gin testified that, 'We are putting in new high capacity machinery at a cost of $101,000.00, in order to take care of the business. * * * We lost a thousand bales or better last year in not being able to gin it.' Each year at the annual meeting, according to the testimony of one of the directors, the matter of setting up a fund to retire the preferred stock is brought up, and always voted down.
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> "The co-op was built with borrowed money, that is, preferred stock, and there is now outstanding 16,790 shares of preferred stock representing, at $10 per share, $167,900.00. The 26 active and voting members of the co-op each have one share of common stock worth $100.00, for a total of $2600.00 (Some of the active members also own substantial amounts of preferred stock. This is not in issue.) The co-op manager testified that there is no market value for the preferred stock. The C.P.A. for the co-op testified that based on ordinary losses, (under the system of distribution practiced by the co-op) it would be very hard to ever build up the general reserve to twenty-five percent.

"It is axiomatic that the owners of a profitable business are entitled to a reasonable share of the profits of that business as well as being able to sell their interest in that profitable business. That is one advantage of our capitalistic system. In the instant case, appellants have received some share of the profits, but have so far been effectively denied any assurance that their stock will be redeemed, while the active members enjoy a profitable return from the investment of the preferred stockholders, all of which impels us to the conclusion that appellee's directors abused their discretion in failing to develop or maintain a rational balance between the amounts paid the preferred stockholders and the active members, and in failing to provide, maintain and build the allocated reserve required by the articles of incorporation.

"We consider this case to be controlled by Driver v. Producers Cooperative, 233 Ark. 334, 345 S.W. 2d 16, and remand the cause for further development in the light of that opinion.

"Reversed and remanded."

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FEDERAL TAXATION - GAINS ON REDEMPTION OF REVOLVING FUND CREDITS HELD CAPITAL GAINS NOT ORDINARY INCOME

(Greenvine Corporation v. Commissioner, 40 T.C. No. 101 (Docket 88771), CCH Dec. 26,292;
R. H. Roussey, et al. v. Commissioner, T.C. Memo. 1963-254 (Dockets 91667, 92270), CCH Dec. 26,314(M))

In these cases the only issue was whether the "revolution" of revolving fund credits constituted a "sale or exchange" under the capital gains provisions of the Internal Revenue Code of 1954. The Commissioner had determined that any income realized from the revolution of revolving fund credits amounted to ordinary income. The Tax Court held that the revolving fund credits had the basic characteristics of both stock and indebtedness and the retirement or redemption of the credits was an exchange under the Code Section 302(a) and 1232 (a)(1), and the gain constituted long-term capital gain rather than ordinary income.

The facts in the Greenvine case were as follows. In 1953 Greenvine, a privately owned corporation, purchased certain revolving fund credits from an agricultural cooperative packing house for less than their face value. The revolving fund credits had been acquired by the packing house while it was a member of the Exchange Lemon Products Company (hereafter called ELPC), a cooperative marketing association. Under ELPC's revolving credit plan, specific sums were retained from the proceeds of members' fruit processed through the ELPC to acquire funds with which to operate ELPC's business. As additional funds were acquired so that the total amount of the fund exceeded the requirements of the cooperative, ELPC paid to the holders of the oldest revolving fund credits the face amount of the credits. The payments to the holders amounted to "revolutions" of the revolving fund credits.

During the taxable years 1956-1958, Greenvine realized a gain from revolution of the credits it held in amounts measured by the difference between the face value of the credits and the discount price paid to the packing house. Greenvine reported this gain as long-term capital gain.

The Commissioner determined that the gains realized by Greenvine amounted to ordinary income on the ground that the normal revolution of revolving fund credits did not constitute a sale or exchange under the capital gains provisions of the Code. Greenvine contended that the credits were either (1) essentially equivalent to the capital stock of ELPC, the reacquisition of which constituted an exchange under Section 302(a), or (2) evidences of indebtedness of ELPC, the retirement of which constituted an exchange under Section 1232(a)(1).

The Tax Court considered the issue of whether the revolution of revolving fund credits was a sale or exchange as one of first impression. It held that the revolving fund credits were hybrid securities having characteristics of both debt and equity. They were like debt because the ELPC had the obligation to repay the face amount of the credits; and they were like equity because they were subject to the risk of enterprise. It was stipulated that the credits were purchased for value and that they were capital assets in the taxpayer's hands, and the Court found it unnecessary to determine their definite character.

In either event, the Court held that the retirement or redemption of the credits was an exchange under the Code and the gains realized constituted long-term capital gain rather than ordinary income.

In the Roussey case, the facts were these. The taxpayer had gained control of all the assets of an investment company including a number of revolving fund credits, also in ELPC. The investment company had been engaged in various farming activities such as raising lemons. Some of the lemons were processed in its own packing house and some through ELPC.

On the authority of Greenvine, the court held that redemptions of these credits received from 1956 through 1959 by the taxpayer amounted to an "exchange" under the Code entitling the taxpayer to capital gain treatment.

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INTERNAL REVENUE SERVICE CLARIFIES PATRONAGE REFUND REPORTING

On October 15, 1963, the Internal Revenue Service issued a Technical Information Release (TIR-517) to clarify the information reporting requirements applicable to patronage refunds of farmer cooperatives under the provisions of the Revenue Act of 1962.

The Technical Information Release follows:

> The Internal Revenue Service today stated that the new $10 reporting requirement for patronage dividends under the provisions of the Revenue Act of 1962 applies only to payments made with respect to patronage occurring on or after the first day of the first taxable year of the paying organization beginning after December 31, 1962. Payments made with respect to patronage occurring in taxable years of the paying organization beginning before January 1, 1963, are subject to the $100 reporting requirement of the prior law.
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> The reason for the announcement is that the revised U. S. Information Return for Calendar Year 1963, Form 1099, reflects the new $10 reporting requirement.
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> Internal Revenue stressed that even though the $10 rule is shown on the form, the $100 rule should be used when applicable.

TRADE REGULATION - PRICE DISCRIMINATION - WHAT CONSTITUTES FALSE BROKERAGE

(Central Retailer-Owned Grocers, Inc., et al. v. Federal Trade Commission, 319 F. 2d 410 (7th Cir.))

The United States Court of Appeals for the Seventh Circuit, in setting aside an order of the Federal Trade Commission (see Summary, Legal Series, No. 21, p. 23), has held that the mathematical comparison between brokerage, when paid by suppliers on sales through brokers, and savings accomplished by a buyer cooperative for its members in its direct dealing with suppliers, was not sufficient evidence to show that there was a payment "in lieu of brokerage" in violation of the Robinson-Patman Act's false brokerage ban.

The cooperative, which is wholly owned by its members, buys, sells, and promotes its own brands of food products and other products that are sold in retail grocery stores. The cooperative receives orders for the various products from its members, invoices its members for such orders at a price higher than its cost, and after paying operating expenses distributes patronage dividends to its members on the basis of the amount of business done by them during the year. It has been granted price reductions, discounts and allowances in connection with the purchasing of merchandise from certain suppliers of the cooperative. The cooperative pointed to the unique way it does business with prospective suppliers. The suppliers are informed that they will receive savings from the cooperative's advance commitments from its members, the lack of credit risk, the fact that the suppliers need look to only one central office for payment instead of to the various offices of its members and the fact that the cooperative supplies its own labels.

The Commission contended that the cooperative was performing services commonly rendered by independently-owned brokers, which it replaced in a large number of purchases and sales transactions. Accordingly, the Commission took the position that sums the cooperative received and accepted from these certain suppliers constituted brokerage or allowances and discounts in lieu of brokerage in violation of the false brokerage ban of the Robinson-Patman Act. The Commission argued that in most instances the amount of price concessions, discounts or allowances could be correlated mathematically with the normal rates of brokerage that the suppliers pay their brokers on regular sales.

In reaching its conclusion the court said, in part:

"It is apparent to us that an inference of the Commission to the effect that Central received commissions, brokerage, or other compensation, or allowances or discounts in lieu thereof, from its suppliers, was improperly drawn from comparisons of brokerage paid by such suppliers on sales which they made through brokers, with the price reductions granted to Central. The inference upon which the Commission's finding and order are based has no substantial evidence in the record to support it. Instead, the record convincingly shows that the payments made by Central to its suppliers were for merchandise which it bought upon its own credit and not on orders of its members transmitted by it to the suppliers. The fact that Central, because of its strong purchasing power, was able to buy at favorable prices, or on discounts and allowances by its suppliers, is not proof that Central was rendering a broker service. It bought on its own order and on its own credit. It was billed by the suppliers and it paid the bills. A broker does not purchase for his own account, is not billed by the seller, and does not make payment to the seller. Central was able to secure favorable prices from its suppliers, because of (1) their assured volume of business, (2) their lack of any credit risk, (3) a reduction in their billing work, and (4) Central's advance commitments for later requirements. The result was that the suppliers knew that, in selling to Central, they were for these reasons realizing savings in their business operations, which enabled Central's members, in turn to benefit when they purchased from Central. Reason does not permit our ignoring these facts in order to declare illegal a worthy effort by a number of wholesale grocers, owned by retailers, to reduce the ultimate sale prices to the consumer, by entering into the arrangement with Central, which made them stronger in their competition with large chain stores.

* * * * *

"The substantial evidence in the record, considered as a whole, lends no support to the inference drawn by the Commission to the effect that Central received or accepted price concessions 'in lieu of brokerage'. It is obvious that, without any facts to support this inference, counsel for the Commission made a mathematical comparison between brokerage, if it had been paid by suppliers on sales through brokers, and the savings accomplished by Central for its members, in its direct dealings with the suppliers. While we see no significant similarity between

> the percentages thus obtained and tabulated in the Commission's brief, we realize the difficulty under which Commission counsel labor in attempting to construct a case against petitioners. However, we doubt whether this synthetic method of proving a violation of § 2(c) is warranted, in the face of abundant, concrete evidence in the record showing that this proceeding is directed against an inherently legitimate enterprise."

The court also noted that there were no savings in brokerage expenses involved in this case and, hence, the principle that price reductions based on alleged savings in brokerage expenses is an "allowance in lieu of brokerage" when given only to favored customers.

Accordingly, the court held that the Commission's order was not supported by substantial evidence and set it aside.

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TRADE REGULATION - TRADEMARKS - EVIDENCE HELD NOT TO ESTABLISH IMPLIED-IN-FACT EXCLUSIVE LICENSE TO USE MARK

(Pacific Supply Cooperative v. Farmers Union Central Exchange and National Cooperatives, Inc., 318 F. 2d 894 (9th Cir.))

Pacific Supply Cooperative (hereafter called Pacific) brought this action against Farmers Union Central Exchange, Inc. (hereafter called FUCE), charging trademark infringement and unfair competition based on the use of such trademark plus other unfair competition allegations. National Cooperatives, Inc. (hereafter called National), was brought in by order of the trial court as an indispensable party, since it is the legal owner and licensor of the trademark "CO-OP" and others involved in the controversy in this case.

The United States District Court for the Eastern District of Washington entered judgment adverse to Pacific and it took an interlocutory appeal to the United States Circuit Court of Appeals, Ninth Circuit, from a judgment of dismissal of all claims against National, and the trademark issue and related issues of pendent unfair competition based thereon against FUCE, preserving the action against FUCE on other issues. The Court of Appeals held that the evidence failed

to establish that Pacific had acquired an implied-in-fact exclusive license to use in the Pacific Northwest the registered trademarks of National through usage, practices and customs of the parties.

Application for certiorari has been filed by Pacific in the United States Supreme Court on October 14, 1963.

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ANTITRUST LAW - PRIVATE SUIT FOR VIOLATION OF CLAYTON ACT SECTION 7

(Gottesman v. General Motors Corporation, 221 F. Supp. 488)

In a first-impression case, the United States District Court for the Southern District of New York has held that the Clayton Act does not authorize the recovery of treble damages for violation of Section 7's restrictions on mergers likely to lessen competition. The question arose in a case brought by certain General Motors stockholders who tried to use the final judgment in United States v. E. I. du Pont de Nemours and Company (353 U.S. 586) as prima facie evidence of their right to treble damages.

The test of illegality under Section 7, the court emphasized, is whether there is a "reasonable probability" that the acquisition is "likely" to result in the condemned restraints. The court was unable to conceive of actual damage resulting from a mere potential monopolization or restraint of trade and, accordingly, dismissed the claim for money damages based on Section 7.

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TRANSPORTATION - "GRANDFATHER" RIGHTS TO HAUL EXEMPT AGRICULTURAL COMMODITIES

(Frozen Food Express v. United States, 219 F. Supp. 131)

This was an action to set aside and annul orders of the Interstate Commerce Commission on the ground that the Commission had materially reduced the scope of authority recommended by the examiner. This reduction resulted from the Commission's rejection, on grounds of remoteness, of evidence preceding January 1, 1957. This had the practical effect of limiting proof of the motor carrier to a single crop season.

The court held that this was wrong. It said that it was proper under the Transportation Act of 1958 to consider both operations prior to January 1, 1957, and the carrier's holding out and solicitation during the entire "grandfather" period as proper standards in determining the motor carrier's bona fide operations on its application for "grandfather" authority.

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MILK MARKETING ORDERS - LITIGATION ON ORDER NO. 16 (UPPER CHESAPEAKE BAY MARKETING AREA)

(Mills v. Freeman, 315 F. 2d 828, cert. denied 375 U.S. 819)

The United States Supreme Court has denied a petition for certiorari filed by Mills Dairy Products Company for a review of the judgment of the United States Court of Appeals for the Fourth Circuit which upheld the validity of the Federal order with respect to the Upper Chesapeake Bay milk marketing order (see Summary, Legal Series No. 25, p. 21).

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MILK MARKETING ORDER - AUTHORITY TO REGULATE MILK PRODUCED BY A HANDLER

The United States Court of Appeals for the Fifth Circuit filed its opinion on December 18 overruling the petition for rehearing by L. B. Vance and Ford Vance, d/b/a Vance Dairy, in the case of Freeman v. L. B. Vance and Ford Vance, d/b/a Vance Dairy, 319 F. 2d 841. In overruling the petition for rehearing, the Court of Appeals held that (1) the Secretary's findings are adequate to show that the intrastate handling of milk in that marketing area directly affects interstate commerce, and (2) the Secretary's order regulating Vance Dairy as a producer-handler "is not a trade barrier in violation of Section 8c(5)(G) of the Agricultural Marketing Agreement Act of 1937 * * * as construed in Lehigh Valley Cooperative Farmers, Inc., et al. v. United States, et al., 1962, 370 U.S. 76." (For an earlier report on this case, see Summary, Legal Series No. 25, p. 23.)

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